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Trade, Foreign Direct Investment and Growth: Evidence from Transition Economies

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Abstract:

Using fixed effects panel data approach, this paper empirically examines the effects of trade and foreign direct investment (FDI) on growth in 13 transition economies of Central and Eastern Europe, and the Baltic region (CEEB). Our analysis suggests that significant positive effect of trade on growth is a robust result for transition economies of this region. In addition, domestic investment appears to be an important determinant of growth. However, in the presence of trade in the growth equation, FDI does not seem to have any significant effect on growth. The estimation of the growth equation without trade renders FDI highly significant suggesting collinearity between trade and FDI. Furthermore, interaction between trade and FDI seems to be important for growth in transition economies. Among other findings, macroeconomic stability as reflected in the rate of inflation and fiscal balance plays a significant role in the growth process.